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# INTERNATIONAL COUNTERTRADE

## Draft Legal Guide on International Countertrade Transactions

## Report of the Secretary-General

## Addendum

## IX. PAYMENT

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[Editorial note: The present draft chapter is a revision of draft chapter IX, "Payment", published as document A/CN.9/332/Add.6. The note in square brackets at the beginning of each paragraph indicates either the number under which the paragraph appeared in document A/CN.9/332/Add.6 or that the paragraph is new. The revisions of paragraphs that appeared in document A/CN.9/332/Add.6 are underlined.]

## A. General remarks

1. [1] The parties may decide that the payment obligation under the supply contract in one direction is to be liquidated independently from the payment obligation under the supply contract in the other direction. When payments are independent, the payment under each supply contract is made in a way that is used in trade generally, such as payment on open account, payment against documents, or letters of credit. Alternatively, the parties may decide to link payment so that the proceeds generated by the contract in one direction would be used to pay for the contract in the other direction, thus allowing the transfer of funds between the parties to be avoided or reduced. The legal guide discusses only linked payment arrangements. It does not discuss independent payment arrangements since they do not raise issues specific to countertrade.

2. [2] One reason the parties may have for linking payments is the possibility that it would be difficult for a party to effect payment in the agreed currency. Another reason may be to ensure that the proceeds generated by the shipment in one direction would be used to pay for the shipment in the other direction. Payment mechanisms designed to meet such needs include retention of funds by the importer (below, paragraphs 9 to 13), blocking funds paid under the export contract through blocked accounts or crossed letters of

credit to secure their availability to pay for the counter-export contract (below, paragraphs 14 to 37), and setoff of countervailing claims for payment (below, paragraphs 38 to 57).

3. [3] An aspect of linked payment mechanisms to be considered is the financing costs that result from the fact that linked payment mechanisms immobilize the proceeds of shipments made by the parties. The longer the interval between the time the proceeds are generated by the contract in one direction and the time those proceeds are used to pay for the contract in the other direction, the greater the financing costs are likely to be.

4. [new paragraph] A characteristic of linked payment mechanisms is the security they provide to the party who has received goods first in that the funds to pay for those goods are not placed at the disposal of the party who has supplied those goods but are reserved to pay for goods subseqently to be supplied in the other direction. This fact may make it easier for that party to obtain a loan to finance its deliveries. The source of financing is often the bank that is holding the funds to be used for paying subsequent deliveries or the bank that is administering a setoff of countervailing claims for payment.

5. [new paragraph] On the other hand, the party who is the first one to deliver goods, or who has delivered more goods than it has received, faces the risk that it will have to wait for an uncertain period of time before goods of the agreed quality are made available for purchase in return or, if such goods are not made available, that the proceeds from the deliveries that that party had made are released to pay for those deliveries. Because of this risk, a bank may be reluctant or unwilling to finance a delivery of goods if payment for those goods is to be deferred until the goods are purchased in return. As a result, in large-scale and long-term projects such as buy-back or indirect offset transactions it is less likely that a linked payment mechanism will be used.

6. [4] The parties may wish to consider the possibility that hindrances might arise in carrying out the linked payments. For example, a creditor of one of the countertrade parties might obtain a court order to seize proceeds of a supply contract, the bank holding the funds might become insolvent, or a payment may be prevented because of supervening banking or foreign exchange regulations. Those cases could result in the freezing of the payment mechanism until the claim against the countertrade party was adjudicated, the bank became solvent or the regulations were lifted, as the case may be. A factor in assessing this risk is the degree of protection the law applicable to the payment mechanism affords against such external circumstances. Furthermore, the longer funds are held in the payment mechanism, or claims for payment wait to be set off, the greater the risk that such hindrances might arise.

7. [5] It should be noted that payment mechanisms may require governmental authorization if they involve a delay in or an absence of repatriation of the proceeds of a supply contract, the holding of funds abroad or the holding of a domestic account in a foreign currency.

8. [new paragraph] It is advisable that the parties agree on the details of the linked payment mechanism in the countertrade agreement. Depending on the type of the payment mechanism chosen, individual supply contracts may have to contain clauses implementing the method of payment agreed upon in the countertrade agreement.

## B. Retention of funds by importer

9. [6] Sometimes it is agreed that the shipment in a particular direction (export contract) is to precede the shipment in the other direction (counter-export contract), and that the proceeds of the export contract are to be used to pay for the subsequent counter-export. Such cases are sometimes referred to as "advance purchase" in view of the fact that the importer is to purchase goods in advance in order to generate financing for the counter-export contract. In such cases, the parties may agree that the proceeds of the export contract will be held under the control of the importer until payment under the counter-export contract becomes due.

10. [7] A consideration as to the acceptability of such an arrangement would be the exporter's confidence that the importer will hold the funds in accordance with the countertrade agreement. Such confidence is more likely to exist when the parties have an established relationship. Another consideration is the risk that the importer will become insolvent or that the funds in the hands of the importer will be subject to a third-party claim. Under ordinary circumstances the claim of the exporter would have no priority over that of another creditor of the importer. In some legal systems, the funds may enjoy a degree of protection against the claims of third parties if the agreement concerning the retention of funds places the importer in a fiduciary position with respect to the funds. For example, in common law systems, this might be done by establishing a "trust" in which the importer acts as the "trustee" of the funds. Fiduciary mechanisms available in some other legal systems may offer similar protection.

11. [8] Furthermore, a disagreement may arise over the type, quality or price of counter-export goods if the countertrade agreement does not specify the type of goods to be counter-exported, or if no standard exists to measure the quality of the type of goods agreed upon. The possibility of such a disagreement increases the risk that for an unacceptable period of time the retained funds will neither be put to the intended use nor released to the exporter. When the parties are able to specify the type of goods, a consideration affecting the acceptability of retention of funds by the importer may be the length of time required to make the counter-export goods available. Retention of funds by the importer might be more acceptable when the goods to be purchased with the retained funds are available in stock and can be shipped quickly, and less acceptable when the goods have to be specially manufactured.

12. [9] An appropriate balance needs to be established between two opposing objectives. One objective is to assure the exporter access to the funds if the counter-export did not take place. The other objective is to assure the importer that the funds will not be transferred to the exporter, at least not the full amount, if the exporter is in breach of the commitment under the countertrade agreement to counter-import. The first objective may be advanced by fixing a date by which the funds have to be transferred to the exporter in the event the counter-export has not taken place. The second objective may be advanced by authorizing the importer to deduct any liquidated damages or penalty that may be due to the importer for the exporter's breach of the countertrade commitment before the funds are transferred to the exporter.

13. [10] Depending upon the length of time the funds are to be retained under the control of the importer, the parties may wish to consider providing in the countertrade agreement for the payment of interest in favour of the exporter. If they do so, the parties may stipulate the manner in which the funds are to be deposited so as to earn interest at the most favourable rate.

## C. Blocking of funds

### 1. General remarks

14. [11] When the exporter does not wish to leave the funds generated by the export contract under the control of the importer, the parties may wish to use another payment mechanism designed to ensure that the proceeds of the first shipment are used for the intended purpose. The legal guide addresses two mechanisms of this type: blocked accounts and crossed letters of credit.

15. [12] When the parties opt for a blocked account, they agree that the importer's payment is to be deposited in an account at a financial institution agreed upon by the parties and that the use and release of the money will be subject to certain conditions. After the funds have been deposited in the account, the importer counter-exports and obtains payment from those funds by presentation of agreed upon documentation evidencing the performance of the counter-export contract to the institution administering the account. Accounts of this nature have been referred to as "escrow", "trust", "special", "fiduciary" or "blocked" accounts. The expression "blocked account" is used here in order to avoid unintended references to particular varieties of such accounts that may be encountered in different legal systems.

16. [13] When the parties opt for crossed letters of credit, the importer opens a letter of credit to cover payment for the export contract ("export letter of credit"). The export letter of credit then serves as the basis for the issuance of a letter of credit to pay for the counter-export contract ("counter-export letter of credit"). Pursuant to the instructions of the parties, the proceeds of the export letter of credit are blocked in order to cover the counter-export letter of credit. The export letter of credit is liquidated when the exporter presents the required documents, including an irrevocable instruction that the proceeds should be used to cover payment under the counter-export letter of credit. Payment under the counter-export letter of credit, which is funded by the export letter of credit, is effected upon presentation of the required documents by the counter-exporter.

17. [14] A blocked account or crossed letters of credit may be used when the importer does not wish to ship the counter-export goods until the availability of funds to pay for those goods is secured. In such "advance purchase" arrangements, both blocked accounts and crossed letters of credit provide security that the funds generated by the shipment in one direction, specifically designated to occur first, would be used to pay for the subsequent shipment in the other direction.

18. [15] The financial drawbacks of blocking funds may be mitigated to some degree if interest accrues on the blocked funds. A bank holding funds designated for paying letters of credit may be less inclined to pay interest than a bank holding funds in a blocked account. For this reason, a blocked account may provide an interest-bearing vehicle for holding excess funds in

anticipation of future orders. This may be helpful in cases where the parties are not certain at the outset as to whether all the proceeds generated by the export will be needed to pay for the counter-export.

2. Blocked accounts

19. [16] Some legal systems provide special legal regimes for blocked accounts if they are established in a particular legal form (e.g., "trust" account or "compte fiduciaire"). In those legal systems, a blocked account would be subject to general contract law if it is not established in such a particular form. When a special legal regime is applicable, the holder of the funds is subject to special fiduciary obligations with respect to the disposition of the funds and the funds may enjoy a degree of protection against seizure by third-party creditors.

20. [17] Contractual provisions outlining the agreement of the parties on the blocked account will be found in the countertrade agreement. In addition, an agreement will have to be concluded between the bank and one or more of the countertrade parties ("blocked account agreement", below, paragraphs 26 to 30). The provisions in the supply contracts concerning the blocked account will normally be limited to identifying the account to be used for payment.

(a) Countertrade agreement

(i) Location of account

21. [18] The parties should consider stipulating in the countertrade agreement the location of the account, by identifying the bank, by indicating the country in which the account is to be opened or by providing some other criterion for the selection of the bank. The choice of possible locations of the account may be limited if the national law of the party whose shipment generated the funds restricts the right to hold currency abroad. In such a case the choice may be limited to establishing the account with a bank located in that party's country.

22. [19] When the parties have a choice as to the location of the bank, they should bear in mind that the location of the account may determine the law applicable to the account. The suitability of the applicable law in a given location may be assessed in view of the security provided to the parties that the fiduciary obligations of the bank will be properly exercised. Furthermore, it is desirable that the applicable legal regime provide some protection against interference by a third-party creditor of one of the parties. As noted above in paragraph 19, a degree of protection may be available under some legal systems against claims of third persons.

(ii) Operation of blocked account

23. [20] It is advisable that the countertrade agreement contain certain basic provisions to be incorporated in the blocked account agreement with the bank. Such provisions enable each party, upon agreeing to the use of a blocked account, to establish that the account will have the features it considers important. These provisions concern, in particular, procedures for the transfer of funds into the account, documentary requirements for transfer of funds out of the account (e.g., payment request using a prescribed form, bill of lading or other shipping document, certificate of quality) and

interest. In addressing the contents of the blocked account agreement in the countertrade agreement, the parties should be aware that the bank is likely to be accustomed to handling blocked accounts on the basis of contract forms or standard conditions.

24. [21] The countertrade agreement may provide that payments into the account would be made through a letter of credit opened by the importer in favour of the exporter. It may also be agreed that disbursement of the funds held in the account would be carried out through a letter of credit opened by the counter-importer in favour of the counter-exporter. In such cases it is advisable that the countertrade agreement specify the instructions to be given to the issuing banks and the documents to be presented under the letters of credit. For example, the beneficiary would be required to present, along with documents evidencing shipment, an irrevocable instruction that the proceeds should be deposited in the blocked account.

(iii) Other issues

25. [22] It is advisable that the countertrade agreement address issues such as amount of funds to be blocked, interest, transfer of unused or excess funds, and any supplementary payments (for a discussion of various issues common to linked payment mechanisms that might be dealt with in the countertrade agreement, see below, paragraphs 58 to 65).

(b) Blocked account agreement

26. [23] The blocked account agreement would contain instructions to the bank and specify the actions to be taken by the trading parties and by the bank, as well as other provisions concerning the operation of the blocked account. The blocked account agreement would also address issues such as interest and bank charges, and the manner in which trading parties may verify the accuracy of interest calculations and other actions taken by the bank in administering the account. It is important to ensure that the blocked account agreement is consistent with the provisions in the countertrade agreement concerning the blocked account.

(i) Parties

27. [24] The blocked account agreement will be concluded between the bank holding the account and one or more of the countertrade parties. In some cases, an additional bank may be a signatory to the blocked account agreement. That may occur where the funds to be paid into the account are to be channelled, by agreement or by mandatory law, through a particular bank. Some national laws require that a blocked account established abroad be held in the name of its central bank and that that bank be a party to the blocked account agreement. In multi-party countertrade situations where the counter-exporter or counter-importer is distinct from the exporter and importer, the additional trading party may also be party to the blocked account agreement.

(ii) Transfer of funds into and out of account

28. [25] The blocked account agreement would set out procedures customarily used by the bank in administering a blocked account. It is advisable that the parties make sure that their agreement as to the manner in

which the funds are to be paid into the account and disbursed from the account to the counter-exporter (see above, paragraphs 23 and 24) is reflected in the blocked account agreement. It may be useful to indicate whether partial drawings are permitted, the manner in which the amount to be paid is to be determined (e.g., on the basis of the face value of the invoice) and whether notification of payment requests would be made to the party that deposited funds in the account. The blocked account agreement would also describe the conditions under which excess or unused funds should be transferred to the exporter, or applied according to its instructions (see below, paragraphs 62 and 63). In the latter case, the blocked account agreement may indicate the terms on which funds would be held before instructions are received from the exporter.

29. [26] It should be noted that the bank holding the blocked funds may require that its responsibility be limited to examining the conformity of the documents included in the counter-exporter's request for payment with the agreed upon requirements, rather than ascertaining whether the underlying contract has been performed. The bank may also require that the counter-exporter, who will be paid from the account, indemnify the bank against costs, claims, expenses (other than normal administrative and operating expenses) and liabilities which the bank may incur in connection with the blocked account.

(iii) Duration and closing of account

30. [27] In order to ensure the availability of the blocked account for the necessary period of time, the blocked agreement should specify that the account will remain open until a certain date or for a period of time following the entry into force of the countertrade agreement. The parties may wish to provide that the blocked account would remain operative for a period of time (e.g., 60 days) following the end of the period for the fulfilment of the countertrade commitment. Such a time period would enable the transaction to be completed as planned in the event that shipment under the counter-export contract took place just before expiry of the fulfilment period or was delayed for justified reasons. The blocked account agreement could indicate, in addition to the passage of an agreed upon period of time, circumstances in which the account would close. These could include an event such as termination of the export contract or of the countertrade agreement.

3. Crossed letters of credit

31. [28] Where the parties wish to block funds using crossed letters of credit, it is advisable that the countertrade agreement include provisions concerning the designation of the participating banks (see below, paragraph 59), the instructions to be given to the participating banks for the issuance of the export letter of credit and the counter-export letter of credit and for the allocation of their proceeds, and the documents to be presented in order to obtain payment. In addition, the parties would have to stipulate that the shipment and presentation of documents in one direction should precede the shipment and presentation of documents in the other direction.

(a) Sequence of issuance

32. [29] The parties may agree that the counter-export letter of credit should be issued prior to the issuance of the export letter of credit. Such a

sequence of issuance may be an important consideration to a counter-exporter whose motive to conclude the import contract was the expectation of being able to counter-export. The failure to issue the counter-export letter of credit, and the resultant absence of a counter-export, may leave the importer liable for costs associated with the import that the importer had originally intended to cover by the proceeds of the counter-export (e.g., commission to a third person for resale of goods purchased under the export contract). In order to protect the interest of the exporter who agrees to open the counter-export letter of credit before the export letter of credit is issued, the parties may agree that payment under the counter-export letter of credit will require documentary proof of the issuance of the export letter of credit.

33. [30] In some cases the parties may decide to open the counter-export letter of credit only when the proceeds of the export letter of credit would be available to cover the counter-export letter of credit. In order to address the risk that the export letter of credit is opened without the counter-export letter of credit being subsequently issued, the parties may wish to include an appropriate liquidated damages or penalty provision in the countertrade agreement.

(b) Instructions for allocation of proceeds

34. [31] The instructions from the importer for the issuance of the export letter of credit should provide that the documents required to be presented to obtain payment include irrevocable instructions from the exporter that the proceeds of the export letter of credit should be used to pay for the counter-export letter of credit upon presentation of the shipping documents relating to the counter-export. The instructions for issuance of the counter-export letter of credit should indicate that payment is to be made using the proceeds of the export letter of credit.

35. [32] Because of the linkage between the proceeds of the export letter of credit and the counter-export letter of credit the choice as to the method of payment of the export letter of credit is limited to payment at sight or payment on a deferred basis. Payment by a bill of exchange, the other option used in practice to defer payment of a letter of credit, is incompatible with the linked payment objective of the crossed letters of credit. When a bill of exchange is used for paying the beneficiary of the letter of credit, the bank obligated to pay would accept the bill drawn by the importer in favour of the beneficiary of the letter of credit. Such a bill gives the beneficiary the possibility to transfer the bill by endorsement to a third person. If the bill were endorsed to a third person, the bank that issued the export letter of credit and accepted the bill would be obligated to pay the holder of the bill (and the importer would be obligated to reimburse the bank that issued the export letter of credit) independently of the crossed-letter-of-credit payment scheme. If the export letter of credit is payable at sight, the bank issuing the export letter of credit is given an irrevocable instruction to retain the funds until a given date for the purpose of paying the counter-export letter of credit. If the export letter of credit is a deferred-payment letter of credit, the bank issuing the export letter of credit would be instructed that, upon the date payment is due, the funds are to be used for payment under the counter-export letter of credit.

36. [33] It is advisable that the instructions for the issuance of the export letter of credit stipulate that the proceeds of the export letter of credit would be paid to the exporter in the event the counter-export fails to materialize. Under an export letter of credit payable at sight, the proceeds would be paid to the exporter if by an agreed date the counter-export goods have not been shipped. If the export letter of credit is payable on a deferred basis, it could be provided that the proceeds will be paid to the exporter if, by the payment date, the counter-exporter has not presented the required documents. Payment to the exporter would also be in order when the proceeds of the export letter of credit exceed what is needed to cover the counter-export letter of credit. If such a situation is foreseen, it is advisable that the importer instruct the issuer of the export letter of credit to transfer to the exporter any proceeds of that letter of credit that are in excess of the specified amount needed to cover the counter-export letter of credit.

(c) Expiry dates

37. [34] It is advisable that the counter-export letter of credit expire a reasonable period of time after the expiry of the export letter of credit. Where the two letters of credit have an identical or almost identical expiry date, insufficient time may remain for shipment and presentation of documents under the counter-export contract if shipment and presentation of documents under the export contract took place at the last minute.

## D. Setoff of countervailing claims for payment

### 1. General remarks

38. [35] The parties may agree that their mutual claims for payment based on shipments made in each direction would be set off. Under such an arrangement, money is not actually paid; instead, the sum of claims arising from the deliveries in one direction are set off against the sum of claims arising from the deliveries in the other direction. If an outstanding balance arises in the values of the deliveries in the two directions, it can be settled by delivery of additional goods or by payment of money. In some States setoff arrangements are subject to governmental authorization.

39. [36] A setoff approach may be utilized when only one shipment is to be made in each direction or when multiple shipments are to be made in the two directions over a longer period of time. This section discusses the record-keeping mechanism that the parties may wish to use to set off payment claims of multiple shipments. Such a record-keeping mechanism, referred to in the legal guide as a "setoff account", is referred to in practice by various terms, including "compensation account", "settlement account" or "trade account".

40. [37] A setoff account may be administered by the parties themselves or by a bank. The engagement of a bank may be prescribed by mandatory rules of law. Banks are also used because the parties may wish that the debit and credit entries in the setoff account be made on the basis of shipping documents examined in accordance with procedures customarily used by banks. Furthermore, banks engaged to administer a setoff account may agree to guarantee the obligation of a countertrade party to liquidate an outstanding balance in the flow of trade.

41. [38] Under one approach to structuring a setoff account, two accounts are maintained for recording debit and credit entries, one at a bank in the country of one party and another one at a bank in the country of the other party. Another approach would be to use a single account administered by a single bank; other banks may be involved for the purpose of forwarding documents and issuing or advising letters of credit.

42. [39] When two banks are involved in administering the setoff arrangement, it is probable that they will conclude an interbank agreement. This interbank agreement may cover some of the points already addressed in the countertrade agreement, as well as establish the technical arrangements relating to the setoff account. The countertrade agreement may refer to the interbank agreement, stating that the technical details of the operation of the accounts will be in accordance with an interbank agreement concluded between the participating banks. Although the countertrade parties are not normally signatories to an interbank agreement, it is advisable that the countertrade parties participate in the preparation of the interbank agreement in order to ensure consistency between the countertrade agreement and the interbank agreement (interbank agreements are discussed below in paragraphs 60 and 61).

43. [new paragraph] An agreement to set off claims arising from a trade relationship is in a number of national laws recognized as a distinct type of contract involving the two parties in the trade relationship and a third person who is to administer the recording of mutual claims. Terms used for such contracts include "compte courant", "cuenta corriente" or "Kontokorrent", although some of these terms are also used for accounts in which a bank holds funds of a client. Those national laws deal with issues such as obligations of the third person administering the setoff, the effect of the entry of a claim in the setoff account, the action necessary for the setoff of the countervailing claims to take effect, the possibility to dispute an individual claim or the balance of the countervailing claims, or the effect of insolvency or bankruptcy of a party on the individual entries in the setoff account.

44. [40] The legal guide does not address State-to-State umbrella agreements for mutual trade within the framework of a clearing account between governmental banking authorities. Under such arrangements the value of deliveries in the two directions is recorded in a currency or unit of account and eventually set off between the governmental banking authorities. Individual traders in each country conclude contracts directly with each other but submit their claims for payment to their respective central or foreign trade bank and receive payment in local currency. Similarly, purchasers pay their respective central or foreign trade bank in local currency for their imports. Such clearing mechanisms, which might be part of economic measures designed to promote trade, fall outside the ambit of the legal guide since the individual supply contracts in one direction concluded under the umbrella agreement are not contractually linked to contracts concluded in the other direction.

## 2. Countertrade agreement

### (a) Effecting credit and debit entries

45. [41] The parties may wish to agree that entries in the account will be triggered by presentation of documents. The countertrade agreement should

stipulate the documents required to be presented by the supplier in order to obtain a credit. The type of documents stipulated depends on the point of time in the execution of a supply contract at which the parties wish to allow credit to be given to the supplier. These documents might include, for example, invoices, packing lists, certificates of quality or quantity, bills of lading or other transport documents, evidence of the customs clearance of the goods in the receiving country or of their acceptance by the purchaser, and any other documents stipulated under the individual supply contracts. The parties may also wish to agree on the contents of any statement which the supplier would be required to make concerning the transaction being credited (e.g., purchase order number, date of shipment, description of the type, quantity and value of the goods, number and weight of the packages, particulars concerning carriage, and reference to the setoff account.)

46. [42] Where it is agreed that entries in the account are to be made on the basis of events occurring in the country of destination (e.g., customs clearance or acceptance by the purchaser), the parties may wish to maintain a parallel record of shipments already in transit, but not yet cleared by the customs authority or accepted by the purchaser. Such a parallel mechanism would provide an indication of the upcoming claims for payment that would be entered in the account once goods in transit have cleared customs or have been accepted by the purchaser. This information would enable the parties to apply certain provisions of the setoff mechanism (e.g., limits on outstanding balance, below, paragraph 53, and settlement of such balance, below, paragraphs 54 to 56) with greater flexibility than might otherwise be the case. For example, the parties may agree that the application of a balance limit to a party in a debit position could be suspended if the value of goods in transit were to be taken into consideration. This would permit a party who would otherwise be barred from receiving additional shipments of goods to continue receiving goods.

47. [43] In a setoff arrangement comprised of a single account, the parties may agree that the presentation of the agreed documents to the administering bank triggers the appropriate debiting or crediting action. A setoff arrangement comprised of two accounts could operate as follows: the purchaser, through its bank, submits to the supplier's bank a copy of a purchase order, and any other documents stipulated in the countertrade agreement or specified in the purchase order. On receipt of the required documents, the supplier's bank debits the purchaser's account. Upon passing the debit entry, the supplier's bank forwards the documents to the purchaser's bank, along with a statement concerning the effective date of the debit entry. The effective date of the debit entry, as agreed upon in the interbank agreement, may be, for example, the date when the documents are dispatched by the supplier's bank to the purchaser's bank. Upon receipt of the documents, the purchaser's bank makes in its books a corresponding credit entry in the supplier's account.

48. [44] Because a setoff account is used for recording the values of shipments rather than for making payments, the use of letters of credit is not necessary. When letters of credit are used, they are used in order to apply established procedures for examination of shipping documents rather than for transferring money. In such cases, the stipulations in the countertrade agreement concerning the instructions to be given to the issuing banks should be aligned with the current revision of the Uniform Customs and Practice for Documentary Credits prepared by the International Chamber of Commerce, which banks customarily incorporate into their letter-of-credit forms.

(b) Calculation of entries

49. [45] The countertrade agreement should indicate the currency or unit of account in which the values of the deliveries are to be expressed (below, paragraph 58). In addition, the parties may wish to address the question whether interest calculated on the amount of an outstanding balance would be registered in the setoff account. Furthermore, the parties may wish to stipulate whether debit and credit entries can be made only on the basis of the required documents evidencing shipment or also on the basis of any claims arising from defective goods or delayed shipment. If debit and credit entries are made only on the basis of shipping documents, claims relating to defective performance of supply contracts would be settled apart from the setoff mechanism. If, however, the parties agree that claims based on defective performance of supply contracts would affect the balance of the setoff account, it is advisable to stipulate the types of documents that would have to be presented in order to alter the balance of the setoff account. For example, the countertrade agreement could require an arbitral award, or a statement by the defaulting party, indicating the amount involved.

50. [46] In order to protect the setoff mechanism against uncertainty that may result from taxation, the parties and the banks may agree that taxes will not appear in the setoff account. Such a provision is intended to facilitate the trade balancing aim of the clearing mechanism by allowing the full value of a given shipment to be credited.

(c) Statements of account

51. [47] It is advisable to consider the manner in which the participating bank or banks will report on the status of the setoff account to the trading parties and to any other participating bank. Agreement on this issue is particularly relevant where one bank maintains the account on behalf of both parties. Where two banks are involved, the question of reporting may be covered in the interbank agreement. Issues to be agreed upon include the frequency, timing and contents of the reports, procedure for objections and period of time within which objections must be made before a report is deemed accepted.

(d) Periodic verification

52. [48] In order to minimize the possibility of errors or discrepancies in the setoff account, the parties may agree to verify the recorded value of shipments in the two directions at fixed points of time. The determination of the outstanding balance can be based, for example, on the preceding statement of account that has been accepted and the subsequent debit and credit entries advised in the agreed upon manner. The parties may wish to be specific as to the length of time within which the checking procedure must be completed (e.g., within seven days of the fixed points of time).

(e) Limits on outstanding balance

53. [49] The parties may agree that at any point in time during the course of the setoff arrangement a credit or debit balance in the setoff account with respect to either party should not exceed an agreed upon balance limit. In accordance with such a balance limit (sometimes referred to as a "swing"), debit and credit entries would not be entered in excess of the

balance limit. It could also be provided that shipments of goods would be suspended to a party whose acceptance of goods without shipping a sufficient quantity in return had resulted in a debit balance reaching the agreed upon limit, or that an outstanding balance in excess of the limit is to be settled by transfer of money. Shipments to that party, and the corresponding debit entries, would resume once the debit balance had been brought within the permissible range.

(f) Settlement of outstanding balance [change of title]

54. [50] It is advisable that the parties agree in the countertrade agreement on the manner of settling an outstanding balance in the values of the deliveries in the two directions that remains at the conclusion of subperiods of the fulfilment period or at the conclusion of the fulfilment period.

55. [50] With respect to an outstanding balance remaining at the conclusion of a subperiod, it may be agreed that the balance would be carried over to the next subperiod. Alternatively, it may be agreed that only a balance up to a specified limit would be carried over to the next subperiod, and that the balance in excess of the limit would have to be settled by cash or by deliveries of goods within a specified shorter period of time. The purpose of limiting the amount of an outstanding balance that is carried forward is to prevent the accumulation of a high outstanding balance that would be difficult to rectify by the end of the fulfilment period.

56. [51] As to an outstanding balance remaining at the conclusion of the fulfilment period, it may be agreed that the balance is to be liquidated by a currency transfer within an agreed period of time. Alternatively, the parties may agree that the balance would be settled after the end of the fulfilment period by deliveries of goods within a fixed supplementary period. If an outstanding balance still remains after the conclusion of the supplementary period, it may be stipulated that it is to be settled by a currency transfer within an agreed period of time.

(g) Guarantee for payment of outstanding balance

57. [52] In a setoff arrangement involving two banks, each bank may guarantee the obligation to liquidate any outstanding balance. Where a single account is maintained by one bank on behalf of both parties, a guarantee covering liquidation of an outstanding balance can be maintained by that bank in favour of whichever of the parties has the outstanding credit balance. The parties may agree that the costs of maintaining such a guarantee be apportioned between them. The amount of a guarantee for payment of an outstanding balance is normally limited to the permitted balance limits under the setoff arrangement. (For further discussion of such guarantees, see chapter XII, "Security for performance", paragraphs [38] to [45].) Parties should be aware that there may be cases, however, where remittance of sums claimed under such guarantees would be subject to prior scrutiny and authorization of exchange control authorities. Sometimes it is possible to obtain prior authorization from exchange control authorities for the remittance of the payment under the guarantee.

## E. Issues common to linked payment mechanisms

### 1. Currency or unit of account

58. [53] The parties should designate the currency or unit of account in which the payment mechanism will operate. A factor of particular importance is stability in exchange rates of the chosen currency. Because of this consideration, the parties may wish to consider using a unit of account (e.g., SDR (Special Drawing Right), ECU (European Currency Unit) or UAPTA (Unit of Account of the Preferential Trade Area for Eastern and Southern African States)). Another factor in choosing a currency is that it be one in which the goods to be traded are typically valued. In setoff accounts, the currency in which the account operates takes on the character of a unit of account because payments are not made in setoff accounts except to liquidate an outstanding debit balance in trade. The parties may therefore denominate a setoff account in a currency that they would not use if payments actually had to be made for each shipment.

### 2. Designation of banks

59. [54] The parties may wish to designate in the countertrade agreement the bank or banks they intend to use to administer the payment mechanism and issue any related letters of credit. When the parties do not designate a bank in the countertrade agreement, they may wish to agree, for example, that the bank would have to have its place of business in a particular country, that the bank must be acceptable to both parties or that the bank selected must be agreeable to an interest-bearing payment mechanism.

### 3. Interbank agreement

60. [55] Where on each side of the countertrade transaction a bank is involved, the participating banks may conclude an interbank agreement concerning technical and procedural aspects of the payment mechanism. The interbank agreement would cover issues such as: statements of account; procedures for notification of interest due; how often interest is to be recorded; interbank communications for the purpose of advising debit and credit entries and transmission of documents; procedures for verification of entries in accounts; banking charges; and modification and assignment of the interbank agreement. While the countertrade parties are not normally parties to the interbank agreement, they have an interest in the contents of the interbank agreement in view of its role in structuring the payment arrangement. It is therefore advisable that the countertrade parties consult with their banks to ensure that the terms of the interbank agreement are consistent with the terms of the countertrade agreement concerning payment.

61. [56] The entry into force and the duration of the interbank agreement may be linked to the entry into force and duration of the countertrade agreement in order to ensure the availability of the payment mechanism at the time the countertrade transaction is to be carried out. It is desirable to provide for the interbank arrangement to continue beyond the expiry or termination of the countertrade agreement for the purpose of settling any outstanding balance. In order to provide the trading parties an opportunity to approve the interbank agreement, the countertrade parties and participating banks might agree that the interbank agreement will enter into force upon the approval by the countertrade parties. In some countries the interbank agreement may require approval of exchange control or other governmental authorities.

### 4. Transfer of unused or excess funds

62. [57] It is advisable that the parties provide for payment to the exporter of the proceeds of the export contract, or application of the proceeds according to the exporter's instructions, in the event that the counter-export does not take place by the agreed date. In order to address the concern of the importer about an arbitrary non-fulfilment of the countertrade commitment, it may be agreed that an amount equivalent to the sum that may be due from the exporter as damages, liquidated damages or penalty for breach of the countertrade commitment would be retained or transferred to a third party pending the resolution of a dispute as to responsibility for the non-fulfilment of the countertrade commitment.

63. [58] A similar provision may be included with respect to funds generated by the export that are in excess of the amount needed to cover the price of the counter-export contract. Transfer of unused funds is also an issue when the parties agree that only a portion of the proceeds of the export contract is to be retained (e.g., as a deposit towards payment for the counter-export), and that the outstanding balance due under the counter-export will be paid at the time the balance becomes due.

### 5. Supplementary payments or deliveries

64. [59] The parties may anticipate that their shipments will not be of equal value or in the planned quantity so that the proceeds of the shipment in one direction will be insufficient to cover payment for the shipment in the other direction. In such cases, it is advisable to agree whether the difference would be settled through additional deliveries or through cash payments.

### 6. Bank commissions and charges

65. [60] It would be advisable for the parties to address in the countertrade agreement the question of payment of bank charges for operation of the payment mechanism. In order to simplify the operation of the payment arrangement, it may be agreed that bank commissions and charges will be recorded separately from entries pertaining to shipment of goods. Where a single bank is used which acts on behalf of both parties, it may be agreed that the bank charges will be shared equally. Where a bank is involved on both sides of the transaction, it may be agreed that the charges of each bank will be paid by its respective client. For example, it may be agreed that the charges for the issuance of a letter of credit will be borne by the purchaser, while charges for negotiation and confirmation, if required, will be borne by the supplier. Charges for extensions or other amendments of letters of credit could be borne by the party responsible for such extension or amendment.

## F. Payment aspects of multi-party countertrade transactions

### 1. General remarks

66. [61] A countertrade transaction may involve one or more third parties. In some cases, in addition to the exporter and the importer, a third-party counter-importer or a third-party counter-exporter is involved ("three-party countertrade"); in yet other cases, in addition to the exporter

and the importer, both a third-party counter-importer and a third-party counter-exporter are involved ("four-party countertrade") (see chapter VIII, "Participation of third parties", paragraphs ____ to ____). The engagement of a third-party counter-importer may occur when the importer needs to sell goods in order to secure funds to cover the cost of the import, but the exporter is not interested in purchasing or is not able to purchase what the importer has to sell. A third-party counter-exporter may be engaged when the importer itself does not have goods of interest to the exporter.

67. [62] If the parties agree that the payment obligations under the export contract and under the counter-export contract are to be settled independently, a countertrade transaction involving third parties does not raise payment issues specific to countertrade. Issues specific to countertrade are raised if the proceeds of the contract between one pair of parties (e.g., importer and exporter) will be used to pay for a contract between a different pair of parties (e.g., importer and third-party counter-importer). In such cases, as described in the following two paragraphs, a party receiving goods does not pay or ship to the party supplying those goods, but instead pays or ships to a third party.

68. [63] In a three-party countertrade transaction involving a third-party counter-importer, the importer, instead of transferring money to the exporter under the export contract, delivers goods to the counter-importer and is considered to have discharged the payment obligation for the import up to the value of countertrade goods delivered to the counter-importer. The counter-importer, in turn, pays the exporter an amount equivalent to the value of the goods received from the counter-exporter. Similarly, in a three-party transaction involving a third-party counter-exporter, the importer transfers funds to the counter-exporter to pay for the shipment to the counter-importer and the counter-importer (exporter) agrees that the claim for payment under the export contract is discharged by the value of the goods that have been counter-exported to him.

69. [64] In a four-party countertrade transaction, where the counter-exporter is a separate party from the importer and the counter-importer is a separate party from the exporter, the exporter ships goods to the importer and the importer, instead of paying the exporter, pays to the counter-exporter an amount equivalent to the value of the goods received from the exporter. The payment from the importer to the counter-exporter compensates the counter-exporter for the shipment to the counter-importer. The counter-importer pays to the exporter an amount equivalent to the value of the goods received from the counter-exporter.

70. [65] Payment in a multi-party countertrade transaction may be structured so that cross-border payment would not be necessary. This would be possible, as between an importer and an exporter, when the importer and the third-party counter-exporter are located in the same country or when the exporter and a third-party counter-importer are located in the same country. When both the counter-exporter and the counter-importer are third parties, cross-border payments may be avoided if both the exporter and the counter-importer are both located in one country and if the importer and the counter-exporter are both located in another country. Where no cross-border transfer of currency takes place, payments would be made in local currency between parties on each side of the transaction.

71. [66] In multi-party countertrade, in addition to the payment-related provisions in the countertrade agreement and in the export and counter-export contracts, there would also be agreements between the exporter and the counter-importer or between the importer and the counter-exporter concerning payment in local currency equivalent to the value of the goods received by a given party and the payment of a commission. Furthermore, an agreement may be concluded between the participating banks concerning the payment mechanism.

72. [67] If one of the supply contracts in a multi-party countertrade transaction is not concluded or performed as envisaged, it will be impossible to use the proceeds of the contract between one pair of parties to pay for a contract between another pair of parties. In view of this interdependence of supply contracts, it is important that measures are taken that provide assurance to the parties that the obligations under the transaction will be carried out as agreed. Accordingly, it is advisable that the obligations incumbent on each party are set out as clearly as possible, in particular the obligations concerning the quality of goods, the sequence of shipments, the manner and sequence of payments, and the instructions to be given to the participating banks. In order to increase the confidence of parties, the parties may agree to carry out, prior to the conclusion of the transaction, an inspection of goods to be delivered, to identify specifically the goods to be delivered, or to place the goods in the custody of a third person pending delivery. In order to facilitate coordination of the obligations of the parties, it is useful to address them in a single countertrade agreement entered into by all the participating parties. Where not all the parties to the multi-party transaction are parties to the countertrade agreement, it is advisable to include in the individual supply contracts terms concerning the linked payment mechanisms.

73. [new paragraph] In order to make the coordination of obligations of the parties to a multi-party countertrade transaction more effective, the parties may wish to stipulate at the outset of the transaction that certain terms of the countertrade agreement or of a supply contract can be modified only if all parties to the transaction agree to the modification. The modifications that should be subject to agreement of the participating parties are in particular those that concern the time of shipments, method of payment, quantity and quality of goods and price. In addition, the parties may wish to consider securing obligations under the transaction by agreeing on liquidated damages or penalties or on independent bank guarantees.

### 2. Blocking of funds in multi-party countertrade

74. [68] As in countertrade involving two parties, blocked accounts and crossed letters of credit may be used in multi-party countertrade. Issues relevant to the use of blocked accounts and crossed letters of credit are discussed in above in paragraphs 14 to 37.

75. [69] When a blocked account is used in a four-party transaction, or in a three-party transaction involving a third-party counter-exporter, the proceeds of the export contract would be held in a blocked account until presentation of documents evidencing performance of the counter-export contract, at which point the funds would be transferred to the counter-exporter. In the event that, by the deadline for presentation of documents evidencing performance of the counter-export contract, those documents have not been presented, the funds would be transferred to the

exporter. In order to establish payment through a blocked account, the exporter and importer conclude a blocked account agreement with the bank selected to administer the account.

76. [70] When crossed letters of credit are used in a three-party transaction involving a third-party counter-exporter, the counter-importer (exporter) opens a letter of credit in favour of the counter-exporter (counter-export letter of credit). Cover for the counter-export letter of credit is obtained from the proceeds of the letter of credit opened by the importer for the benefit of the exporter (export letter of credit). The exporter obtains access to the shipping documents relating to the counter-export goods by presenting evidence of shipment under the export contract and an instruction that the proceeds of the export letter of credit should be used to cover the counter-export letter of credit. Similarly, in the case of a three-party transaction involving a third-party counter-importer, the proceeds of the export letter of credit could be used to cover the counter-export letter of credit.

77. [71] When crossed letters of credit are used in a four-party transaction, the importer, who obtains the issuance of the export letter of credit, deposits with the issuing bank of the export letter of credit the amount of that letter of credit. Upon the instruction of the exporter, the proceeds of the export letter of credit are not paid to the exporter, but are blocked to cover the counter-export letter of credit. Upon the presentation by the counter-exporter of shipping documents under the counter-export letter of credit, the funds deposited by the importer to cover issuance of the export letter of credit are paid to the counter-exporter; on the other side of the transaction, the counter-importer pays the exporter an amount equivalent to the value of the goods received by the counter-importer. If the counter-exporter does not present shipping documents under the counter-export letter of credit, the funds deposited by the importer to cover the export letter of credit would be transferred to the exporter.